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CAPITAL EXTERNALITIES IN TWO-SECTOR MODELS

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Capital Externalities in Two-Sector Models*

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Abstract: We consider a two-sector economy with positive capital externalities and constant social returns. We first show that local indeterminacy does not require external effects from labor but is fundamentaly based on externalities derived from capital in the investment good sector. Second, we show that the external effects in the investment good sector has to be characterized by a low enough amount of capital stock from the consumption good sector. In other words, the existence of multiple equilibria is ruled out if the externalities are too intersectoral.

Keywords: *Infinite horizon models, sector-specific and intersectoral capital externalities, constant social returns, indeterminacy.*

Journal of Economic Literature Classification Numbers: C62, E32, O41.

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